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**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance With *Government Auditing
Standards***

Delaware Department of Transportation
Dover, Delaware

We have audited the financial statements of the State of Delaware Department of Transportation (Transportation) as of and for the year ended June 30, 2006, and have issued our report thereon dated November 21, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered State of Delaware Department of Transportation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Transportation's ability to initiate, record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses as items 2006-1 through 2006-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether Transportation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management at the Department of Transportation in a separate letter dated November 21, 2006.

This report is intended solely for the information and use of the Secretary of Transportation, management, Office of the Governor, Attorney General, Comptroller General, Management and Budget, Department of Finance and the U.S. Department of Transportation and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 21, 2006



2006-1 - ACCOUNTING FOR CAPITAL ASSETS AND INFRASTRUCTURE

Observation

In order to calculate the ending capital asset balances for inclusion in the DelDOT financial statements, DelDOT uses various departmental maintained spreadsheets and reports as well as BACIS expense reports to calculate the balance of capital assets and infrastructure. DelDOT does not currently have a fixed asset subsidiary ledger that can roll-forward all of the elements typically contained in fixed assets records, including asset identification, location, historical cost, acquisition date, useful life, depreciation, accumulated depreciation, and funding source. These records are traditionally rolled forward from beginning of year to end of year with additions, deletions, and depreciation. These records will allow for the required every other year physical inventory of equipment required by the Federal Government, and improve the controls over year end financial reporting.

The application of the modified approach requires determining if capital program expenditures are for preservation and maintenance or additions to the capacity of infrastructure. The department currently has a sub-appropriation code in BACIS that tracks infrastructure additions so that expenses can be coded correctly when they relate to infrastructure. There appears to be no clear procedure to review all projects to determine if and how much of a project adds capacity to the infrastructure assets for the purposes of financial reporting so the appropriate coding can be done in BACIS. Our review of projects identified three additional projects that were considered by the DelDOT project managers to add system capacity but they were not coded as such in BACIS. The review identified an additional \$20 million in additions and \$28 million of prior period additions related to these projects.

Recommendation

The capital asset infrastructure comprises a significant portion of DelDOT's total assets. As such, we recommend that the balances be centrally managed in a fixed asset subsidiary ledger that has the capability to track current items as described above, additions, deletions and calculate depreciation.

The determination as to whether or not a project adds capacity for purposes of financial reporting should be coded by individuals who have a working knowledge of the project and determined at the beginning stages of the project development. DelDOT should establish clear guidelines and procedures for determining whether a project adds capacity for purposes of financial reporting. The results of this review should be coded into BACIS so that appropriate additions can be identified for the projects.



Management's Response

The Department of Transportation recognized the importance of managing the capital asset balances for inclusion in the financial statements. As a result of the above noted recommendations the Department proposes the following:

1. Develop a comprehensive Department Policy Implement which identifies clear guidelines and procedures. The development of this policy will involve division directors and staff from Transportation Solutions, Technology and Support Services, Maintenance and Operations as well as Finance. We will work collaboratively in considering a fixed asset subsidiary ledger. The Policy Implement will be provided in draft form to the Directors by January 30, 2007 with a planned implementation by February 28, 2007.



2006-2 ACCOUNTING FOR MISCELLANEOUS REVENUE

Observation

Revenue from contracts settlements and recoveries is not subject to management's review for the purpose of determining the appropriate accounting treatment for year end financial reporting purposes in accordance with generally accepted accounting principles. The agreements with CSX and Shellpot both required additional review and adjustment.

Recommendation

We recommend that management establish a formal review process over contracts entered into by the Department effecting revenue for the purpose of determining the year end accounting treatment for all significant transactions.

Management's Response

A Department Policy Implement will be established identifying the Transportation Trust Fund Administrator as the designated management representative for determining accounting treatment for year-end financial reporting. The Policy Implement will be provided to the directors by January 30, 2007 with a planned implementation by February 28, 2007.